

On Date 1, Decedent established Trust, a revocable trust pursuant to State law. Trust was subsequently amended and restated five times. The current co-trustees are Decedent's son, Decedent's brother-in-law, and Decedent's attorney. Decedent died on Date 2, survived by Spouse, children, grandchildren, and great grandchildren.

Articles Second and Third of Trust, provide that following certain specific bequests, the remainder of the trust estate is to be held in three trusts, the Credit Shelter Trust, the GST Trust, and the Residuary Trust.

Paragraph A of Article Third provides that the trustees shall hold the Credit Shelter Share in further trust (Credit Shelter Trust) and pay over or apply the net income of the Credit Shelter Trust, in the trustees' absolute discretion, to one or more members of a class consisting of Spouse and Decedent's living descendants. The trustees may also apply over or apply so much of the principal to one or more members of a class consisting of Decedent's living descendants. Upon the death of Spouse, the principal and any net income of the Credit Shelter Trust shall be paid over as provided in Article Fourth.

Article Third provides that the trustees shall fund the GST Trust with an amount equal to the Decedent's unused Generation-Skipping Transfer Tax exemption as provided in § 2631 available at her death to the extent it is not allocated to other property by the trustees or the executors of the Decedent's estate. Paragraph B of Article Third provides that the trustees shall hold the GST Share in further trust (GST Trust) and pay over or apply the net income of the GST Trust at least annually to Spouse. Spouse shall also have beneficial enjoyment of the trust estate of the GST Trust during his lifetime. Upon the death of Spouse, the principal and any net income of the GST Trust shall be paid over as provided in Article Fourth. The GST Trust was intended to qualify for the deduction under § 2056(b)(7).

Paragraph C of Article Third provides that the trustees shall hold the Residuary Share in further trust (Residuary Trust) and pay over or apply the net income of the Residuary Trust, at least annually, to Spouse. Paragraph C also provides that Spouse is to have the beneficial enjoyment of the trust estate of the Residuary Trust during his lifetime and, upon his death, the principal and any net income of the Residuary Trust shall be paid over as provided in Article Fourth. The Residuary Trust was intended to qualify for the deduction under § 2056(b)(7).

Paragraph 11 of Article Tenth provides that the trustees are authorized to divide property in any trust being held with an inclusion ratio, as defined in § 2642(a)(1), of neither one nor zero into two separate trusts representing two fractional shares of the property being divided, one to have an inclusion ratio of one and the other to have an inclusion ratio of zero.

Spouse, as executor of the estate, engaged Law Firm to prepare and assist her in the timely filing of Decedent's federal estate tax return, Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. On Schedule M, Bequests, etc., to Surviving Spouse, the estate made the election under § 2056(b)(7)(qualified terminable interest property) the residue of the estate, establishing the Marital Trust of \$A. On Schedule R, Generation-Skipping Transfer Tax, \$B of Decedent's GST exemption was allocated to direct skips pursuant to Article Second. Decedent had previously allocated \$C to prior gifts leaving \$D of available GST allocation at the time of Decedent's death. Law Firm did not advise Spouse, as the executor of the estate, to sever Marital Trust into an exempt trust and non-exempt trust, to make the reverse QTIP election under § 2652(a)(3) or to allocate Decedent's GST exemption to the nonexempt portion of the Marital Trust. These errors were discovered by Law Firm on Date 3, upon review of Spouse's estate plan.

On Date 4, the co-trustees divided the Marital Trust into the GST Trust and the Residuary Trust, as directed by Trust, by executing a severance agreement. The GST Trust is to be funded with a fractional share of Decedent's estate passing to the Marital Trust, the numerator of which is equal to the Decedent's remaining GST exemption after taking into account prior allocations of GST exemption and automatic allocation of GST exemption to other trusts created under the terms of Trust and the denominator of which is equal to the amount passing to the Marital Trust. The Residuary Trust is to be funded with the balance of the property passing to the Marital Trust. Accordingly, the GST Trust will be the GST exempt portion of the Marital Trust and the Residuary Trust will be the GST non-exempt portion of the Marital Trust. The GST Trust and the Residuary Trust are to be funded on a non pro rata basis, based on either the fair market value of the asset on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the Decedent's date of death to the date of funding. A reverse QTIP election will then be made with respect to the GST Trust. The terms of the GST Trust and the Residuary Trust provide in the aggregate for the same succession of interests and beneficiaries as are provided in the Marital Trust.

According to State Statute, the trustee of an express trust is authorized without prior court approval or the consent of the persons interested to establish two or more separate trusts in order to segregate property held in trust which is or would be excepted, excluded or exempt from or under Chapter 13 (tax on generation-skipping transfers) of the United States Internal Revenue Code from such property which is not so excepted, excluded or exempt, so that one or more of such separate trusts will have an inclusion ratio of zero, or so that one or more of such separate trusts qualify for the grandchild exception under section 1433(b)-(d) of the Tax Reform Act of 1986, as amended.

Decedent's estate requests rulings under § 301.9100-03 granting the following:

1. To sever Marital Trust under § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, into a GST exempt portion known as the GST Trust and a GST non-exempt portion known as the Residuary Trust;
2. To file a supplemental Form 706 making a reverse QTIP election under § 2652(a)(3) with respect to the GST Trust;
3. To allocate Decedent's available GST exemption under § 2632(e) to the severed GST Trust.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate shall, except as limited by § 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Under § 2056(b)(1), no deduction is allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Under § 2056(b)(7)(A), "qualified terminable interest property" is treated as passing to the surviving spouse for purposes of § 2056(a) and no part of the property is treated as passing to any person other than the surviving spouse. Qualified terminable interest property is defined under § 2056(b)(7)(B)(i) as property: (1) which passes from the decedent to the surviving spouse; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under § 2056(b)(7)(B)(v) applies. Under § 2044, property subject to a QTIP election for which a deduction is allowed under § 2056(b)(7), is includible in the surviving spouse's gross estate on that spouse's subsequent death.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if: (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property; and (II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Section 2056(b)(7)(B)(v) provides that an election under § 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by § 2001. Such an election, once made, shall be irrevocable.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made by a transferor to a skip person. A GST is defined under section 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means with respect to any GST transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction". The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred reduced by the sum of any federal estate tax or state death tax actually recovered from the trust attributable to such property and any charitable deduction allowable under § 2055 or § 2522 with respect to such property.

Under § 2631(a) as in effect during the years involved in this case, for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)) that may be allocated by the individual (or his executor) to any property with respect to which the individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, is irrevocable.

Section 2632(a)(1) provides that an individual's GST exemption may be allocated at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such return is required to be filed.

Under § 26.2632-1(d)(1), an allocation of a decedent's available GST exemption by the executor of the decedent's estate is made on Form 706 filed on or before the date prescribed for filing the return by § 6075(a) (including any extensions granted). An allocation of GST exemption with respect to property included in the gross estate of a decedent is effective as of the date of death.

Under § 2632(e)(1) and § 26.2632-1(d)(2), a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. The unused exemption is allocated: (A) first, to property which is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts, with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death. However, no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the new trust.

Section 2642(b)(2) provides generally that if property is transferred as a result of the death of the transferor, the value of the property for purposes of determining the inclusion ratio under § 2642(a)(1) shall be the value of the property as finally determined for estate tax purposes.

Section 2642(g)(1)(A) provides, generally, that the Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption described in § 2642(b)(1) or (2), and an election under § 2632(b)(3) or (c)(5). Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of § 2642(g)(1)(A), which was enacted into law on June 7, 2001.

Under § 2652(a)(1) and § 26.2652-1(a)(1), the "transferor" of the property for GST tax purposes is the individual with respect to whom the property was last subject to federal estate or gift tax. However, under section 2652(a)(3), in the case of a trust for which a deduction was allowed under § 2056(b)(7), the decedent's estate may elect to treat all of the property in the trust as if the § 2056(b)(7) election had not been made for purposes of the GST tax (i.e., a "reverse QTIP election"). Accordingly, the decedent, and not the surviving spouse, is treated as the transferor of the property for GST tax purposes. The reverse QTIP election is irrevocable and is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies. Under § 26.2652-2(b), the reverse QTIP election is made on the return of tax on which the QTIP election is made.

Under § 26.2654-1(b)(1), the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or local law; and

(A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust;

(B) The severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the Federal estate tax return (including extensions actually granted) for the estate of the transferor; and

(C) The new trusts are severed on a fractional basis. If severed on a fractional basis the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trust may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding.

See § 26.2654-1(b)(4) Example 3.

Under § 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute).

Notice 2001-50, 2001-34 I.R.B. 189, provides, in part, that under § 2642(g)(1)(B), the time for allocating the GST exemption to transfers at death is to be treated as if not expressly prescribed by statute. The Notice further provides that taxpayers may seek an extension of time to make an allocation described in § 2642(b)(2) under the provisions of § 301.9100-3.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer has acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Based on the facts and representations made, we have determined that the standards of §§ 301.9100-1 and 301.9100-3 have been met. Therefore, an extension of time is granted until 60 days from the date of this letter to sever Marital Trust into a GST exempt portion, known as the GST Trust, and a GST non-exempt portion, known as the Residuary Trust, and to make a "reverse" QTIP election with respect to the GST Trust. As a result of the severance and the "reverse" QTIP election with respect to the GST Trust, Decedent's remaining GST exemption will be allocated to the GST Trust and Credit Shelter Trust under § 2632(e)(1). Therefore, assuming the trusts are funded as described above, the Credit Shelter Trust and GST Trust will have an inclusion ratio of zero, and the Residuary Trust will have an inclusion ratio of 1.

The reverse QTIP election and allocation of GST exemption should be made on a supplemental Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return). The supplemental Form 706 should be filed on behalf of Decedent's estate with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

William P. O'Shea
Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy for § 6110 purposes
Copy of this letter